APPENDIX A

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

No. 2:94CV00124 GFG

FLOYD E. RILEY,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

MEMORANDUM

This matter is before the Court on plaintiff's Motion for Summary Judgment. On November 2, 1994 plaintiff brought suit against the United States to recover $2,000, plus interest, representing a penalty paid to the IRS pursuant to 26 U.S.C. § 6672. Thereafter, the United States filed a counterclaim against plaintiff for the unpaid balance of such penalty in the amount of over $650,000. Plaintiff has filed a motion for summary judgment. Defendant opposes that motion.

Rule 56(c) of the Federal Rules of Civil Procedure provides that summary judgment shall be entered "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." In ruling on a motion for summary judgment, the court is required to view the facts in the light most favorable to the non-moving party and must give that party the benefit of all reasonable inferences to be drawn from the underlying facts. *AgriStor Leasing v. Farrow*, 826 F.2d 732, 734 (8th Cir. 1987). The moving party bears the burden of showing both the absence of a genuine issue of material fact and

his entitlement to judgment as a matter of law. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87 (1986); Fed. R. Civ. P. 56(c).

Once the moving party has met his burden, the non-moving party may not rest on the allegations of his pleadings but must set forth specific facts, by affidavit or other evidence, showing that a genuine issue of material fact exists. Fed. R. Civ. P. 56(e). *Anderson*, 477 U.S. at 257; *City of Mt. Pleasant v. Associated Elec. Coop., Inc.*, 838 F.2d 268, 273-74 (8th Cir. 1988). Rule 56(c) "mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986).

The Internal Revenue Service ("IRS") may impose a 100% penalty against persons responsible for the collection of employee withholding taxes who willfully fail to pay over those taxes. 26 U.S.C. § 6672. The parties agree that the IRS assessed such a penalty against plaintiff in the amount of $683,675.24. The assessment was for employee withholdings made in first, second, and third quarters of 1990 allegedly not paid to the IRS by a company known as FERCO Fabricators, Inc. ("FERCO").

The following facts are not disputed. On September 17, 1991 after the taxes at issue were due, plaintiff filed for bankruptcy protection under Chapter 7 of the Bankruptcy Code. (Pl. Exh. 1.) On May 18, 1992 the IRS sent plaintiff a Notice of Proposed Assessment of the § 6672 penalty; the notice warned plaintiff that the threatened penalty would be processed if he did not protest it within 30 days. (Pl. Exh. 3.) In a letter dated June 8, 1992 plaintiff, through his attorneys, advised the IRS that the proposed assessment violated the automatic stay provisions of

11 U.S.C. § 362(a). (Pl. Exh. 4.) The IRS disagreed with plaintiff's position and on June 16, 1992 plaintiff appealed the IRS's assessment by mailing a protest letter. (Pl. Exh. 2.) On June 30, 1992 the Bankruptcy Court entered its discharge order. (Pl. Exh. 5.) Mr. Riley's appeal of the proposed assessment was eventually denied and the purported assessment was made the following year. Later, after paying $2,000 of the penalty, plaintiff initiated this action.

Under the version of § 362 of the Bankruptcy Code applicable to this case,[1] the filing of a bankruptcy petition operates as a stay and blocks "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title." 11 U.S.C. § 362(a)(6). However, the filing of a petition does not operate to stay "the issuance to the debtor by a government unit of a notice of tax deficiency." 11 U.S.C. § 362(b)(9).

There is a split among the circuits regarding whether violations of the automatic stay are void or voidable. The Fifth Circuit has held that the violations of the automatic stay are voidable. *Picco v. Global Marine Drilling Co.*, 900 F.2d 846 (5th Cir. 1990); *Sikes v. Global Marine, Inc.*, 881 F.2d 176 (5th Cir. 1989). The First, Second, Third, Sixth, Ninth, Tenth, and Eleventh Circuits have all held that violations are void *ab initio*. *Schwartz v. United States*, 954 F.2d 569 (9th Cir. 1992); *Ellis v. Consolidated Diesel Elec. Corp.*, 894 F.2d 371 (10th Cir. 1990); *Smith v. First American Bank*, 876 F.2d 524 (6th Cir. 1989); *In re Ward*, 837 F.2d 124 (3d Cir. 1988); *48th Street Steakhouse, Inc. v. Rockefeller Group, Inc.*, 835 F.2d 427 (2d Cir. 1987), *cert. denied*, 485 U.S. 1035 (1988); *Borg-Warner Acceptance Corp. v. Hall*, 685 F.2d 1306 (11th Cir. 1982); *In re Smith Corset*

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[1] The Bankruptcy Code was amended in 1994, but the amendments are not retroactive. Bankruptcy Code Amendments of 1994, Pub. L. No. 103-394, § 702(b), 108 Stat. 4107 (codified in scattered sections of 11 U.S.C.).

Shops, Inc., 696 F.2d 971 (1st Cir. 1982). The Eighth Circuit has not yet addressed this issue. This Court finds persuasive and adopts the reasoning herein of the majority of courts addressing this issue. Therefore, any violation of the automatic stay will be deemed void *ab initio.*

In this case, the plain language of § 362(b)(9) protects only notices of tax "deficiencies," not "penalties" and forecloses the government's argument that a § 6672 "penalty" is similar enough to a "deficiency" to be exempted from the automatic stay. The government also contends that the Notice of Proposed Assessment in this case did not constitute an assessment of or an effort to collect the liability. However, the government describes the effect of the notice sent in this case as follows:

> [I]n the event a Trust Fund Recovery Penalty is asserted [under § 6672], the taxpayer will not be sent a notice of deficiency. Rather, the IRS sends a Notice of Proposed Assessment to the taxpayer allowing him either to agree to the assessment by signing the Form 2751 or providing a thirty-day period within which to appeal the proposed assessment by filing a protest with the Secretary. If the taxpayer agrees to the assessment, fails to respond to the notice, or fails to present sufficient facts in his protest to support non-assertion of penalty, the IRS will assess the taxpayer a penalty.

(Def. Resp. to Pl. Mot. for Summ. J. at 6.) The effect of the Notice was to force plaintiff to take steps to prevent the assessment and had plaintiff not taken such steps the IRS would have assessed the penalty while the automatic stay was still in effect. The Notice described above clearly falls within the range of acts prohibited by § 362(a) as they are designed to initiate assessment against the debtor of a claim that arose prior to the filing of his bankruptcy petition. Cf. *Schwartz v. United States*, 954 F.2d 569 (9th Cir. 1992); *Spears v. United States*, 143 B.R. 950 (N.D. Okla. 1992); *Olson v. United States*, 133 B.R. 1016 (D. Neb.

1991). Therefore, the Notice of Proposed Assessment at issue violated the automatic stay such that it is void *ab initio.*

The government further argues that the Notice was not a mandatory procedure in its efforts at assessing the penalty, and that therefore the fact that the Notice was sent while the automatic stay was in effect does not effect the validity of the assessment made after discharge. While the IRS may not have been required to follow those procedures which resulted in the assessment, it nevertheless did and those procedures initiated with the Notice forced plaintiff while protected by a stay to participate in procedures which led to the assessment in this case. Accordingly, the Court will grant plaintiff's Motion for Summary Judgment.

Dated this 25th day of October, 1995.

/s/ George F. Gunn, Jr.
GEORGE F. GUNN, JR.
UNITED STATES
DISTRICT JUDGE

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

No. 2:94CV00124 GFG

FLOYD E. RILEY,
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

JUDGMENT

Pursuant to the memorandum filed herein on this date,

IT IS HEREBY ORDERED that plaintiff's Motion for Summary Judgment is granted.

IT IS FURTHER ORDERED that defendant's Motion for Summary Judgment is denied.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that judgment is entered in favor of plaintiff and against defendant on plaintiff's complaint in the amount of $2,000 plus interest.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that judgment is entered in favor of plaintiff and against defendant on defendant's counterclaim.

IT IS FURTHER ORDERED that all other pending motions are denied as moot.

Dated this 25th day of October, 1995.

/s/ George F. Gunn, Jr.
GEORGE F. GUNN, JR.
UNITED STATES
DISTRICT JUDGE

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

Nos. 96-1021/96-1302

Floyd E. Riley,
Appellee/Cross-Appellant,

v.

United States of America,
Appellant/Cross-Appellee.

Appeal and Cross-Appeal from the United States District Court for the Eastern District of Missouri.

Submitted: April 14, 1997
Filed: July 7, 1997

Before McMILLIAN, Circuit Judge, HENLEY, Senior Circuit Judge, and BEAM, Circuit Judge.

BEAM, Circuit Judge.

The United States appeals the district court's summary judgment order concluding that Floyd E. Riley is entitled to a $2,000 tax refund. Riley cross-appeals the court's denial of his motion for attorney fees. We reverse the court's summary judgment order and remand for further proceedings.

I. BACKGROUND

Through 1990, Floyd E. Riley was associated, in various capacities, with Ferco Fabricators, Inc., a company in Moberly, Missouri. During this time Riley was majority shareholder and at one point served as chairman of the board of directors. The government alleges that in 1990, while Riley was still involved with Ferco, the company failed to remit to the government more

than $680,000 it had withheld from employees for social security and income taxes.

Riley filed for Chapter 7 bankruptcy in September of 1991, and received his discharge in June of 1992. During this time, the Bankruptcy Code's automatic stay was in effect, entitling Riley to protection from all actions to recover claims against him that arose before he filed his bankruptcy petition. *See* 11 U.S.C. § 362(a)(6).

On May 18, 1992, during the period of the automatic stay, the Internal Revenue Service issued to Riley a notice of proposed assessment of a penalty for Ferco's unpaid taxes, pursuant to I.R.C. § 6672. The notice informed Riley that he could either agree to pay the proposed assessment or could file an appeal with the agency within thirty days. Riley protested the proposed assessment, claiming that it violated the automatic stay and that, in any event, he was not responsible. In August of 1993, more than a year after the stay expired, the IRS issued the assessment. Riley paid $2,000, representing a portion of the assessment, and made a claim for a refund. After the IRS denied his claim, Riley brought this refund action in the district court.

On Riley's motion for summary judgment, the district court found that the notice of proposed assessment violated the automatic stay. The district court concluded that this rendered the assessment void and granted Riley's request for a refund. *Riley v. United States*, 192 B.R. 727, 730 (E.D. Mo. 1995). In a later order, the court denied Riley's request for attorney fees and costs, concluding that the IRS's position, though erroneous in the court's view, was substantially justified. The government appeals the court's grant of summary judgment, and Riley appeals the denial of his motion for fees.

II. DISCUSSION

When a corporation fails to pay withheld employee "trust fund" taxes, the IRS may impose a penalty equal to one hundred

percent of the deficiency on any individual who is a "responsible person" and who willfully failed to pay the taxes. I.R.C. § 6672. *Olsen v. United States*, 952 F.2d 236, 239 (8th Cir. 1991). A section 6672 assessment is presumed correct, and it is the individual's burden to show, in a refund action, that he or she was not a responsible person or did not willfully fail to pay over the taxes. *Id.*

Under the version of the Bankruptcy Code applicable to this case, a notice of deficiency from the IRS to a taxpayer is specifically exempted from the automatic stay provision. *See* 11 U.S.C. § 362(b)(9) (1988). The district court rejected the agency's argument that a notice of proposed assessment under section 6672 is the same as a "notice of deficiency" for purposes of the stay, and therefore concluded that the IRS's actions were not exempted from the stay requirements. The agency apparently concedes this issue on appeal. Indeed, assuming that a notice of proposed assessment was not exempted from the stay requirements of the applicable version of the Bankruptcy Code, it is apparent that the agency's proposed assessment to Riley violated the stay. The notice forced Riley to either submit to the assessment, pursue appeals within the agency, or (as Riley did) make a partial payment and then bring a refund action. The proposed assessment thus intruded on the period of repose that the automatic stay provides the bankruptcy petitioner.

The actual assessment, however, was issued long after the automatic stay expired. Riley argues, and the district court concluded, that the agency's issuance of the *notice* of proposed assessment during the stay renders the subsequent assessment "void ab initio."[1] Riley suggests two ways that the improper

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[1] The district court held that the stay violation rendered the assessment void ab initio, rather than merely "voidable." *Riley*, 192 B.R. at 729. We find this theoretical question beside the point in this case, and so decline to address it.

issuance of the notice might render the later assessment void. We find neither theory persuasive.

First, the assessment might be invalid if the improperly issued notice means that the IRS failed to follow required procedures, and so failed to perfect its claim. The problem for Riley is that at the time of the events in question, the Internal Revenue Code did not require the agency to issue any notice before assessing a penalty under section 6672. Not until 1996 did Congress amend section 6672 to require the agency to issue a preliminary notice to the taxpayer before imposing an assessment. *See* Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 901(a), 110 Stat. 1452, 1465 (1996) (codifying notice requirement at 26 U.S.C. § 6672 (b)). Riley argues that Revenue Procedure 84-78, 1984-2 C.B. 754 (1984), imposed such a requirement. Revenue Procedures that involve distinctly procedural matters not otherwise controlled by statute, however, are not binding on the agency. *See, e.g., Estate of Jones v. Commissioner*, 795 F.2d 566, 571-72 (6th Cir. 1986). Neither the Bankruptcy Code nor the Internal Revenue Code requires that we render "void ab initio" an assessment for $680,000 in unpaid taxes because that assessment was issued after a "void" notice that the agency was under no obligation to issue in the first place.

Second, Riley suggests, it is proper to void the assessment because this would be a proper remedy for the agency's earlier violation of the stay. Any damages Riley incurred from responding to the agency's proposed assessment, however, were a matter for the bankruptcy court. Whatever remedy Riley might be entitled to for the IRS's stay violation is irrelevant to his burden in bringing this refund action: to show that he was not a responsible person or that he did not act willfully in failing to pay Ferco's trust fund taxes.

Because we hold that the IRS should have prevailed below on Riley's motion for summary judgment, we affirm on that basis the district court's denial of Riley's motion for attorney fees.

III. CONCLUSION

The district court's grant of summary judgment to Riley is reversed, and the denial of Riley's motion for attorney fees is affirmed. The case is remanded for further proceedings not inconsistent with this opinion.

A true copy.

ATTEST:

CLERK, U.S. COURT OF APPEALS,
EIGHTH CIRCUIT

APPENDIX C

11 U.S.C. § 362 Automatic Stay (1988 ed.)

(a) Except as provided in subsection (b) of this section, a petition filed under [the Bankruptcy Code] . . . operates as a stay, applicable to all entities, of —

(1) The commencement . . . of . . . [an] administrative, or other action or proceeding against a debtor that . . . could have been commenced before the commencement of the case under this title, or to recover a claim against a debtor that arose before the commencement of the case under this title; . . .

(6) Any act to collect, assess, or recover a claim against a debtor that arose before the commencement of the case under this title. . . .

* * *

(d) On request of a party in interest and after notice and hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay —

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest. . . .

* * *

(h) An individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and in appropriate circumstances, may recover punitive damages.

11 U.S.C. § 549 Postpetition Transactions (1988 ed.)

(a) Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transaction of property of the estate —

(1) that occurs after the commencement of the case; and

(2)(A) that is authorized only under section 303(f) or 542(c) of this title; or

(B) that is not authorized under this title or by the court.